

Docket No.: 01-0796
ROM Date: 03-04-03
Deadline: 03-22-03

MEMORANDUM

TO: The Commission

FROM: William J. Showtis, Administrative Law Judge

DATE: February 25, 2003

SUBJECT: MidAmerican Energy Company

Application for approval pursuant to Section 7-101 of the Public Utilities Act of an agreement for the provision of insurance services to MidAmerican Energy Company by its affiliates MidAmerican Energy Holdings Company and CE Insurance Services Limited.

RECOMMENDATION: Enter an order on rehearing approving the agreement, subject to certain restrictions and conditions.

MidAmerican Energy Company ("MidAmerican") seeks approval to enter into an Insurance Services Agreement ("Agreement") with its indirect corporate parent, MidAmerican Energy Holdings Company ("MEHC") and its captive insurance affiliate, CE Insurance Services Limited ("CEISL"). The Agreement authorizes MidAmerican to enter into captive insurance arrangements for non-nuclear insurance services indirectly as a participant in an MEHC insurance program or directly with CEISL. MidAmerican's testimony indicates that a captive insurance company is a licensed and closely regulated bona fide insurance or reinsurance company that is owned by a non-insurance company parent and is formed to insure or reinsure the risks of its parent and/or affiliated companies.

On September 11, 2002, the Commission entered an order in this proceeding which denied MidAmerican's request for approval to enter into the Agreement. The September 11, 2002 order reached the conclusions set forth in the next three paragraphs.

While the Commission has previously approved a captive insurance arrangement for Illinois Power Company in Docket 96-0291, that decision is not dispositive of the request in the instant proceeding. Commission orders have no *res judicata* effect in subsequent proceedings and the Commission's decision here must be based on the record.

The Commission recognizes that obtaining insurance from a captive insurance company has potential benefits. However, a more careful examination of this type of arrangement is warranted for a regulated utility. We recognize that affiliates of Mid American are very skilled insurance experts. Nonetheless we are concerned that more detail about the manner in which the captive would function, its capital and surplus structure and the types of risks it would accept were not made a part of this record. There was no discussion of proposed ratios of capital and surplus to premiums nor was there any discussion of re-insurance arrangements the captive insurer would enter into with re-insurance companies. For instance, would some type of risks be subject to quota share arrangements while others would be on a facultative basis? While captive insurers may initially save the insured substantial premiums, the financial integrity of the captive insurer is of primary concern to this Commission and unfortunately the record does not provide sufficient details regarding this critical item.

The Commission is concerned that with the captive insurance arrangement, MidAmerican will have an incentive to act in a manner that is more favorable to its parent, MEHC, rather than in the best interests of its ratepayers. MidAmerican has an incentive to file fewer claims with the captive and pursue claims less aggressively than if it obtained insurance from commercial insurers. This incentive exists since filing and aggressively pursuing claims could result in lower profits for the parent. This incentive must be weighed against potential cost savings from the captive insurance arrangement. The record does not demonstrate and the Commission does not believe that obtaining insurance from the captive will result in significant savings. It is reasonable to assume that the commercial insurance market appropriately considers the risk of MidAmerican in determining insurance premiums. MEC witness Diesing could not definitively state that MidAmerican's cost of obtaining insurance from the captive would be lower than the cost in the commercial insurance market. Weighing the aforesaid incentive against potential cost savings from the captive insurance arrangement, the Commission concludes that it is in the public interest to deny approval of the Insurance Services Agreement between MidAmerican, MEHC and CEISL.

The evidence presented on rehearing is summarized on pages 8-11 of the attached order on rehearing. The order on rehearing concludes that MidAmerican's testimony satisfies the Commission's concerns regarding the financial integrity of CEISL. The order on rehearing, concludes, however, that the Commission remains concerned that with the captive insurance arrangement, MidAmerican will have an incentive to act in a manner that is more favorable to its parent, MEHC, rather than in the best interests of its ratepayers. The order on rehearing states that the Commission continues to believe that MidAmerican has an incentive to file fewer claims with the captive and pursue claims less aggressively than if it obtained insurance from

commercial carriers. The order on rehearing approves the Agreement, subject to certain conditions proposed by MidAmerican and subject to the following restriction proposed by Commission Staff ("Staff"): approval of MidAmerican's purchase of insurance from CEISL is limited to replacement insurance for periods of less than or equal to one year, if there are cancellations in coverage from unaffiliated commercial insurers; MidAmerican shall notify the Commission when such transactions take place and seek to renew all expiring insurance contracts with coverage through unaffiliated insurance carriers. The restrictions and conditions on approval of the Agreement are set forth in Finding (4) on pages 12-13 of the order on rehearing.

WJS/js